Internal Revenue Service

memorandum

CC:INTL-0516-91
Br6:Lorence

date: OCT 21 1991

to: Revenue Service Representative - [redacted]

from: Thomas D. Fuller, Chief, Branch 6
Associate Chief Counsel (International)

subject: Taxation of Exchange Teachers

THIS DOCUMENT CONTAINS PRIVILEGED INFORMATION UNDER SECTION 6103 OF THE INTERNAL REVENUE CODE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE OUTSIDE THE IRS, INCLUDING THE TAXPAYERS INVOLVED, AND ITS USE WITHIN THE IRS SHOULD BE LIMITED TO THOSE WITH A NEED TO REVIEW THE DOCUMENT FOR USE IN THEIR OWN CASES.

In your letter of May 16, 1991, you inquired whether income earned by [redacted] teachers in the United States under a teacher exchange program is taxable by the United States. The [redacted] teachers are public school teachers employed by the [redacted], which continues to pay their salaries while they teach in the United States.

From the limited facts available to us, we believe that the income is not taxable by the United States by virtue of section 893 of the Code and the Income Tax Treaty between the United States and [redacted] (the Treaty).

Section 893 provides that wages of an employee of a foreign government received as compensation for official services to that government are exempt from United States income tax, provided:

a) the employee is not a citizen of the United States,

b) the services are of a character similar to those performed by employees of the U.S. government in foreign countries; and

c) the foreign government grants an equivalent exemption to employees of the U.S. government who perform similar services in the foreign country.

However, pursuant to §1.893-1(a)(5) of the Income Tax Regulations, an employee of a foreign government who executes and files with the Attorney General the waiver provided in section

247(b) of the Immigration and Nationality Act waives the exemption conferred by section 893.[1]

Section 893(b) provides that the Secretary of State shall certify to the Secretary of Treasury the names of the foreign countries that grant an equivalent exemption and the character of the services that are exempted.

Section 1.892-7T(a) of the regulations provides that the term "foreign government" as used in section 893 has the same meaning as given the term in section 1.892-2T of the regulations.[2] Section 1.892-2T(a)(1) provides that the term "foreign government" means only the integral parts and controlled entities of a foreign sovereign. Political subdivisions of a foreign country are included within this definition.[3] An integral part of a foreign sovereign means any organization, agency, bureau, or other body, however designated, that constitutes a governing authority of a foreign country. The net earnings of the governing authority must be credited to its own account or to other accounts of the foreign sovereign, with no portion inuring to the benefit of any private person.[4]

In this case, the State of [redacted] is a political subdivision of the Commonwealth of [redacted] and from the limited facts available to us, the [redacted] appears to be an integral part within the meaning of §1.892-2T(a)(2) and therefore qualifies as a foreign government for purposes of section 893.

The term "official services" is not defined for purposes of section 893. We interpret the term to mean services performed by a government employee that are in connection with his employment and benefit his employer, the foreign government. While cases and rulings do not define the term, their facts indicate that such a definition is appropriate. For example, in Rev. Rul. 72-

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[1] An employee who wishes to retain the status of an immigrant in the United States must execute and file a waiver under section 247(b) of the Immigration and Nationality Act (8 U.S.C. 1257(b)). After the waiver's filing date, the exemption under section 893 no longer applies to income received by the alien.

[2] That regulation defines the term for purposes of section 892 of the Code, which exempts certain income of foreign governments.

[3] §1.892-2T(d) of the regulations.

[4] §1.892-2T(a)(2) of the regulations.

54[5], compensation paid by a foreign government to an employee visiting the United States for the purpose of observing pollution control methods for eventual use in the foreign country was held to be exempt from taxation under section 893. In Louis Vial v. Commissioner, 15 T.C. 403 (1950), an employee of the Chilean government was sent to the United States to supervise the dismantling of a U.S. steel mill for shipment to Chile as part of that government's economic development program. The Court held that the employer (a government "corporation" under Chilean law) was a foreign government and that the income was exempt under section 893.

In this case, the [redacted] sponsors the teacher exchange program in hopes that by sending its teachers to the United States they will become better teachers and render better services in [redacted]. In our opinion, services performed as part of a program intended to improve a governmental employee's performance of governmental functions are "official services" under section 893. Accordingly, if the Secretary of State certifies that [redacted] provides a reciprocal exemption and the other conditions of section 893 and the regulations are met, we believe that the income is exempt under section 893.

If the Secretary has not so certified, some relief may be available under the Treaty. Article 19 of the Treaty provides that wages paid by the [redacted] government to an [redacted] citizen for the performance of governmental functions in the United States is exempt from taxation in the United States. Article 19 provides that the [redacted] government includes political subdivisions such as state and local governments and their respective agencies. From the facts available to us, we believe that the [redacted] is a "foreign government" for purposes of Article 19.

The term "governmental functions" is not defined under the Treaty. We ascribe to it the same meaning that we ascribed to the term "official services" under section 893.[6] Therefore, we believe that the [redacted] teachers perform "governmental functions" for purposes of Article 19.

Article 19, however, applies only to citizens of [redacted]. Therefore, teachers who are residents of [redacted] but not citizens thereof do not qualify under the article. These

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[5] Rev. Rul. 72-54, 1972-1 C.B. 213.

[6] Under the Technical Explanation to Article 19, the term "governmental functions" will be defined according to the law of the country where the income arises, in this case the United States.

teachers nevertheless might qualify for an exemption under Article 15 of the Treaty, which provides that wages earned by an Australian resident for dependent personal services performed in the United States are not taxable in the United States, provided:

a) the recipient is present in the United States less than 183 days for the taxable year[7],

b) the remuneration is paid by an employer who is not a resident of the United States, and

c) the remuneration is not deductible in determining the taxable income of a permanent establishment, fixed base, or trade or business which the employer has in the United States.

In the case at hand, if the income is exempt under section 893 or any of the treaty provisions, withholding under section 1441 of the Code is not required. However, the teachers must still file Form 1040NR pursuant to section 1.6012-1(b)(1) of the regulations (and, if a treaty exemption is claimed, additional information required under section 1.6114-1 must be attached to the return).[8]

In the event any income is not exempt under section 893 or the Treaty, such income is taxable under section 871(b) of the Code and subject to withholding under section 1441 of the Code.

If you have any further questions or comments, please call Bob Lorence or me at FTS 566-6645.

Thomas D. Fuller

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[7] It is conceivable that a teacher will be present in the United States 183 days or longer. However, section 7701(b)(9) of the Code provides that the calendar year will be a nonresident alien's taxable year, unless he established a fiscal year as his taxable year prior to the period he is subject to U.S. income tax. The normal school year encompasses two calendar years. Therefore, a teacher might be present in the United States less than 183 days for each calendar year, although his total stay for the twelve month period would be over 183 days. In that case, the teacher would still qualify for the Article 15 exemption.

[8] See also Priv. Ltr. Rul. 8718030 (May 8, 1987).